

Metropolitan King County Council

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MANAGEMENT LETTER

DATE: March 5, 2003

TO: Metropolitan King County Councilmembers

FROM: Cheryle A. Broom, County Auditor

SUBJECT: Take-Home Vehicle Taxability Issue

This memorandum provides the results of our follow-up review of the take-home vehicle taxability issue. This follow up to our 2001 management audit on Take-Home Vehicle Policies and Practices was included in the Auditor's Office 2002 work program.

We conclude that King County is generally in compliance with the Internal Revenue Code (IRC) by reporting as additional compensation to employees the appropriate taxable value of the use of employer-provided vehicles.

Our methodology for this review included identifying the applicable provisions in the IRC and how they affect King County's take-home vehicle program. We also reviewed applicable provisions of the King County Code, county policies and procedures, Fleet Management reports, and take-home vehicle, payroll and other financial records.

Background

The take-home vehicle taxability issue arose from the King County Auditor's Office management audit titled Take-Home Vehicle Policies and Practices (Report No. 2001-01), which questioned the county's consistency in reporting the fringe benefit value of using county vehicles. The review focused on compliance with the tax code including determining and assessing any tax liabilities.

The King County Code (Chapter 3.30) defines an assigned take-home vehicle as a county vehicle which is used by its employee for county business and for regular commuting to and from the employee's home and work site.

Section 61 (a) 1 of the Internal Revenue Code provides that gross income includes compensation for services, including fringe benefits. The IRC regulations provide that the use of an employer-provided vehicle is a fringe benefit includible in the employee's wages unless it is specifically excluded from gross income.

The personal use of the employer-provided vehicles that is unrestricted is almost always a taxable benefit, and the taxable value is determined based on annual lease value or cents-per-mile methods. However, if no personal use of the vehicle is allowed other than for commuting or *de minimis* personal use, the taxable value for commuting to and from home and work can be determined under the commuting rule (Reg. 1.61-21(f)(3)), which is \$1.50 per one-way commute.

Also, under the code (Section 132-5 (h)), qualified nonpersonal use of vehicles by employees is a working condition fringe benefit. A qualified nonpersonal use vehicle is any vehicle the employee is not likely to use more than minimally for personal purposes because of its design. Qualified nonpersonal use vehicles generally include:

- Clearly marked police and fire vehicles.
- Unmarked vehicles used by law enforcement officers if the use is officially authorized.

Generally, the county appropriately reported the taxable portion of the vehicle fringe benefits related to commuting between work and home.

The county provides some employees vehicles to be used for county business. These vehicles are assigned to employees based upon the criteria established by King County Code (KCC) Chapter 3.30. The use of employer-provided vehicles for commuting (home to work site and vice versa) creates an incident of taxation. Unless exempted by the Internal Revenue Code, the amount of personal use as defined by IRC is reportable as income to employees. Generally, the county applied the IRS commuting rule, which is \$1.50 per one-way commute.

The audit staff noted that the county routinely reported the taxable portion of the personal use of county vehicles as additional income to employees. As such, the employees and the county paid the appropriate payroll taxes and state retirement system contributions for the added compensation.

Subsequent to the audit, Finance and Business Operations Division corrected W-2s for some executive employees who had unrestricted use of county vehicles.

Subsequent to our management audit, the Finance and Business Operations Division (FBOD) performed a review of its reporting process to ensure that the county is complying to tax laws and regulations. As a result of its review, W-2s for some "control" employees (executives whose compensation equals or exceeds the compensation paid to federal government employees holding a defined executive level position per Reg. 1.61-21 (f)(6)) were corrected for tax years 1998, 1999, and 2000 to reflect the additional compensation from the use of county-provided vehicles. These employees had unrestricted use of county vehicles for county business and personal purposes. The taxable value of auto fringe benefit was determined based on annual lease value of vehicles per IRS regulations. The audit staff was informed by FBOD that the medicare tax portion was not paid by the employees and the county for those years so FBOD would make necessary correction and remittance to the IRS. It should be noted that this practice of unrestricted use of county vehicles by some employees was discontinued in August 2000.

FBOD's draft policies and procedures will improve vehicle fringe benefit reporting.

Also, as a result of the audit, the FBOD reviewed the vehicle fringe benefit reported in the payroll and take-home vehicle reports of the Fleet Management and other agencies for 2001. The FBOD noted some discrepancies (e.g., payroll-reported income greater than the commute rule calculation would allow for trips reported and number of commuting miles). FBOD drafted changes to its policies and procedures to improve its reporting and minimize discrepancies between Fleet Management and other agency reports. It also sought guidance from the Prosecuting Attorney's Office to clarify business versus commuting miles.

Bert Golla conducted this follow-up review. Please contact Bert at 296-0378 or me at 296-1655 if you have any questions about the issues discussed in this letter.

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cc: Ron Sims, County Executive
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